Internal Revenue Service
memorandum

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CPTello-Br6

date: NOV 26 1991

to: Paul Zdunek
International Examiner

from: Chief, Br 6 CC:INTL:6

subject: [redacted]

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This memorandum confirms our oral advice concerning the sourcing of losses from the sale of the stock of a foreign subsidiary for taxable year [redacted]. For the reasons discussed below, we believe that the losses should be treated as foreign source losses.

By telephone, you have indicated that [redacted] ([redacted]), a U.S. corporation, sold a wholly-owned Brazilian subsidiary in [redacted] at a loss. This subsidiary was engaged in the active conduct of a trade or business in Brazil and derived more than 50 percent of its gross income from this active conduct of a trade or business. [redacted] treated this loss as a U.S. source loss on its taxable year [redacted] income tax return.

Section 865 (f) of the Internal Revenue Code sources the gain from the sale of a subsidiary that is at least 80-percent owned by a U.S. resident corporation as foreign source gain if the sale occurs in the foreign country where the subsidiary is engaged in the active conduct of a trade or business and more than 50 percent of the gross income of the subsidiary for the 3-year period immediately preceding the taxable year of the sale was derived from the active conduct of a trade or business in that same country.

Section 865 (j) (1) provides that rules for determining the source of losses will be prescribed by regulations. Regulations under section 865, however, have not been promulgated.

[redacted] meets all of the requirements under section 865 (f) so that had the sale resulted in a gain rather than a loss, the gain would have been treated as foreign source gain under section 865 (f).

We have determined that the loss from the sale by [redacted] of the Brazilian subsidiary should be sourced as a foreign source loss based upon the fact that gain from the sale of the stock would have resulted in foreign source gain, that dividends paid by the subsidiary to [redacted] were treated as foreign source dividends, and that foreign source income from the active trade or business of the subsidiary received the benefit of deferral until [redacted] chose to repatriate such income. Treating the loss as a foreign source loss results in a tax treatment that is more consistent with the underlying economics of the business conducted by [redacted] in Brazil through its subsidiary.

While it is not free from doubt what law applies in the absence of regulations, if the formerly applicable rule under section 1.861-8 (e) (7) were to be applied, the loss would also be foreign source because the dividends paid with respect to the Brazilian subsidiary stock are foreign source dividends.

Please telephone Carol Tello of this office at (202) 377-9493 if you have further questions.

Thomas D. Fuller

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